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In the Supreme Court of the United States

OCTOBER TERM, 1977

NATIONAL AUTOMOBILE DEALERS ASSOCIATION, INC.,
PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL
RESERVE SYSTEM

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The decision of the court of appeals (Pet. App. 41a-42a) is reported at 571 F. 2d 674. The opinion of the Board of Governors of the Federal Reserve System (Pet. App. 1a-40a) appears at 41 Fed. Reg. 45977.

JURISDICTION

The judgment of the court of appeals was entered on February 21, 1978. The petition for a writ of certiorari was filed on April 18, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether automobile lease financing, when conducted by bank holding companies in accord with the Federal Reserve Board's regulation, is "closely related to banking" and thus authorized by Section 4(c)(8) of the Bank Holding Company Act.

2. Whether the Consumer Leasing Act prohibits bank holding companies from relying on the lessee's guarantee of as much as 60 percent of the cost of a leased automobile.

STATEMENT

Section 4(a) of the Bank Holding Company Act, 70 Stat. 135, as amended, 12 U.S.C. 1843(a), generally prohibits a regulated bank holding company from owning shares in any company that is not a bank. Section 4(c)(8) of the Act, 12 U.S.C. 1843(c)(8), however, provides an exception which allows bank holding companies to own shares in a nonbank company:

> the activities of which the Board * * * has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Section 4(c)(8) requires the Board, in determining whether a particular activity is a "proper incident" to banking, to consider whether the activity "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."

The Board's Regulation Y, 12 C.F.R. 225.4(a), currently specifies 12 nonbanking activities that the Board

has determined are closely related to banking.[1] Bank holding companies that wish to engage in these specified activities must apply to the Board for specific approval so that the Board can determine whether the particular activity will satisfy the public benefits test set forth in Section 4(c)(8). See 12 C.F.R. 225.4(b).[2]

Since 1971 the Board has recognized the leasing of personal property, subject to certain restrictions, as an activity "closely related to banking." 36 Fed. Reg. 10777. Following the 1974 amendment of the Board's leasing regulation, 39 Fed. Reg. 11254, petitioner sought review of that regulation in the court of appeals insofar as the regulation permitted bank holding companies to lease automobiles. The court granted the Board's motion to remand the case to the Board for further administrative proceedings and more detailed findings on this issue. *National Automobile Dealers Association* v. *Board of Governors*, C.A.D.C., No. 74-1431, decided October 22, 1975. The Board requested public comment (40 Fed. Reg. 53272, 41 Fed. Reg. 4022), and approximately 100 interested parties, including petitioner, responded (Pet. App. 1a-2a).

The Board again concluded that automobile leasing, under certain restrictions, is a permissible activity for bank holding companies (Pet. App. 1a-40a). The Board's regulation permits personal property leasing provided that the "lease is to serve as the functional equivalent of an extension of credit * * *." 12 C.F.R. 225.4(a)(6)(i)(a). The

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[1] The activities include credit card operations, certain types of financial advice, courier services, and so forth.

[2] A bank holding company also may apply for the Board's permission to engage in a nonbanking activity that is not one of the 12 activities specified. 12 C.F.R. 225.4(a).

lessor bank holding company cannot acquire an inventory of property for leasing, 12 C.F.R. 225.4(a)(6)(i)(b), and it must dispose of the property or lease it again within two years of the expiration of the initial lease. 12 C.F.R. 225.4(a)(6)(i)(f). The maximum lease term is 40 years. 12 C.F.R. 225.4(a)(6)(i)(e). The bank holding company cannot provide non-financial services; therefore, with respect to automobiles, the bank holding company is prohibited from providing maintenance or repair service, purchasing parts for the lessee, loaning automobiles during servicing of the leased vehicle, or obtaining insurance or licenses. 12 C.F.R. 225.4(a)(6)(i)(c) and n. 4. Finally, the lease must allow the bank holding company to recover, over the term of the lease, its full investment in the leased property, plus financing costs, from rental payments, estimated tax benefits, and the estimated residual value of the property at the expiration of the initial term of the lease. 12 C.F.R. 225.4(a)(6)(i)(d). The Board has limited the amount of this estimated residual value to 20 percent of the acquisition cost or, in the case of leases of seven years or less, to 60 percent of the acquisition cost, provided that the lessee or a financially qualified third party guarantees recovery of the residual value in such short-term leases.

The Board determined that automobile leasing, when conducted in accord with these limitations, is "closely related to banking" within the meaning of 12 U.S.C. 1843(c)(8) (Pet. App. 3a-18a). First, the Board found that banks historically have leased many sorts of personal property, and both national and state banks have participated in the growth of automobile leasing in recent years (*id.* at 3a-6a). Second, the Board found that, as limited, automobile leasing is functionally equivalent to a loan and thus is a financial activity (*id.* at 6a-18a). The Board then considered the public benefits test of the Act

(*id.* at 18a-38a) and concluded that automobile leasing by bank holding companies, in general, "can reasonably be expected to produce benefits to the public * * * that outweigh possible adverse effects * * *." 12 U.S.C. 1843(c)(8). The Board indicated that the question whether leasing by a particular bank holding company would be in the public interest will be considered when the company applies to engage in that activity (*id.* at 3a, 18a-19a).

The Board also determined that the Consumer Leasing Act of 1976, Pub. L. 94-240, 90 Stat. 257-260, 15 U.S.C. 1667-1667e, which was enacted during the Board's proceedings, does not prohibit bank holding companies from engaging in automobile leasing or prohibit them from relying on the lessee's guarantee of as much as 60 percent of the acquisition cost of the leased vehicle (Pet. App. 10a-13a).

Petitioner then sought review of the Board's decision in the court of appeals. The court affirmed that decision, stating that it was "in general agreement with the reasons stated by [the Board] in support of its order" (Pet. App. 42a).

ARGUMENT

1. The Board's determination that automobile leasing, as restricted by the Board's regulation, is closely related to banking is based on findings (1) that both national and state banks have long engaged in leasing automobiles and other types of personal property, and (2) that such automobile leasing is functionally equivalent to services generally provided by banks, *i.e.*, making secured loans (Pet. App. 3a-18a). This determination is consistent with the uniform judicial construction of the phrase "closely related to banking" in the Bank Holding Company Act, 12 U.S.C. 1843(c)(8). See *National Courier Association* v. *Board of Governors of Federal Reserve System*, 516 F. 2d 1229, 1237 (C.A.D.C.); *Alabama Association of Insurance*

Agents v. *Board of Governors of Federal Reserve System*, 533 F. 2d 224, 241, modified on rehearing, 558 F. 2d 729 (C.A. 5), certiorari denied, February 27, 1978 (No. 77-668). Petitioner does not challenge the tests employed by the Board and approved by these courts; it argues, instead, that automobile leasing is a merchandising rather than a financial activity (Pet. 5, 13-14). The Board, however, carefully considered and rejected petitioner's contentions (Pet. App. 7a-10a, 12a-18a). There is no reason for this Court to review the Board's decision, which turns more on a characterization of leasing than on any legal dispute.[3]

Petitioner asserts that a holding company's reliance on the residual value of the leased automobile destroys the financial nature of the transaction. But the Board found that, in practice, bank holding companies uniformly obtain the lessee's guarantee of the amount of the residual value (Pet. App. 9a). The guaranteed residual is comparable to a balloon payment at the termination of a secured loan. The holding company cannot rely on a residual value exceeding 20 percent of the acquisition cost unless it obtains a guarantee, and the Board found that this amount (generally the minimum expected resale value of an automobile at the end of a two or three year lease) "is a small enough percentage of the original price of the automobile to ensure that the holding company will be

[3]Petitioner states that, under the Board's decision, "Automobile dealers and other small independent lessors must now meet the direct competition" of bank holding companies (Pet. 12-13). But nothing in the federal statute is intended to protect dealers from competition. The Board must guard against anti-competitive holding company stictures, but it is hard to argue that intense competition from new competitors is "anti-competitive." See Pet. App. 29a. See also *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477,

truly financing a lessee's acquisition and use of a vehicle rather than conducting a short-term rent-a-car operation" (Pet. App. 8a, 9a).[4]

2. The decision below is consistent with *M & M Leasing Corp.* v. *Seattle-First National Bank*, 563 F. 2d 1377 (C.A. 9), petition for a writ of certiorari pending, No. 77-1325. *M & M* held that automobile leasing by national banks is part of "the business of banking" authorized by 12 U.S.C. 24 (Seventh), provided that the lessor bank "assumes [no] material burdens other than those of a lender of money and is subject to [no] significant risks not ordinarily incident to a secured loan." 563 F. 2d at 1380. This test, like the Board's regulation, 12 C.F.R. 225.4(a)(6)(i)(c) and n. 4, precludes the lessor bank from providing operating services. 563 F. 2d at 1383. *M & M* rejected the contention that automobile leasing is inherently a merchandising activity. 563 F. 2d at 1380. It also held that a bank's activities in disposing of the vehicle at the end of a lease do not destroy the financial character of the arrangement. 563 F. 2d at 1383.

There are minor differences between *M & M* and the Board's regulation with regard to reliance on the residual value of the leased vehicle. The Ninth Circuit held that a national bank can properly rely on the lessee's guarantee of the residual value (563 F. 2d at 1384), although that court did not have before it the limitation of 60 percent of the acquisition cost imposed by the Board's regulation. 12

[4]The Board also found that less than 10 percent of all vehicles leased are actually returned to the lessor bank or bank holding company at the end of the lease (Pet. App. 16a). In other cases the lessee disposes of the vehicle. Thus, as the Board concluded, "the banks are not in the merchandising of used automobiles but are merely incidentally disposing of a few vehicles as they would in the case of repossession on a secured auto loan" (*ibid.*).

C.F.R. 225.4(a)(6)(i)(d). As the Board found, however, the 60 percent figure corresponds to the maximum residual value for most vehicles after a two or three year lease (Pet. App. 10a), so, in practice, the guaranteed residual value is not apt to exceed that amount even if no limit is prescribed. *M & M* held that national banks may rely on a non-guaranteed residual value only if it "contributes insubstantially to the bank's recovery of its advances plus interest" (563 F. 2d at 1384), while the Board prescribed a limit of 20 percent of the acquisition cost. 12 C.F.R. 225.4(a)(6)(i)(d). The Board explained that the 20 percent amount would not create a risk of loss "significantly greater than in a loan transaction" and would not lead to transactions in which the lessor would be "speculating in the value of the property" (Pet. App. 9a). Even assuming that the Board's 20 percent limitation may be somewhat more lenient than the "contributes insubstantially" test of the Ninth Circuit, the two decisions are hardly in conflict (see Pet. 15 n. 32), since they affect different banking or bank-related entities. Furthermore, bank holding companies, through their national banking subsidiaries, can engage in all activities that national banks can, and can themselves engage in activities "closely related to" banking. Therefore, *M & M's* limitation on a national bank's reliance on residual values is not necessarily transferrable to bank holding companies.

3. The Board and the court of appeals also properly rejected petitioner's argument (Pet. 16-17) that the Board's regulation conflicts with the Consumer Leasing Act of 1976, 15 U.S.C. 1667-1667e. That Act limits the liability of the lessee at the expiration of a consumer

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[5]A "consumer lease" is a lease of personal property by a natural person for a period exceeding four months where the lessee's total contractual obligation does not exceed $25,000 and the property is primarily for personal, family, or household purposes. 15 U.S.C. 1667(1).

lease[5] to "a reasonable approximation of the anticipated actual fair market value of the property on lease expiration." 15 U.S.C. 1667b(a). The Act further establishes "a rebuttable presumption that the estimated residual value is unreasonable to the extent" that it exceeds three average monthly rental payments under the lease (*ibid.*).[6] The Act provides that the lessor shall not collect "the amount of such excess liability upon expiration of a consumer lease unless the lessor brings a successful action with respect to such excess liability" or unless the parties reach an agreement after the termination of the lease about liability for the excess (*ibid.*).

Petitioner contends (Pet. 16) that the Board's 60 percent limitation on guaranteed residual values is inconsistent with 15 U.S.C. 1667b(a) and that no guarantee of the residual value of property subject to a consumer lease can be unconditional in light of the rebuttable presumption of that provision. The Board considered and correctly rejected these arguments (Pet. App. 10a-13a, 30a-32a). The legislative history of the Consumer Leasing Act discloses that Congress was aware of both the present litigation and the district court decision in *M & M*, which held that national banks could engage in leasing only if the residual value was guaranteed or nonexistent.[7] Neither House intended the Act to prohibit leasing by national banks or bank holding companies. H.R. Rep. No. 94-544, 94th Cong., 1st Sess. 10, 17-18 (1975); S. Rep. No. 94-590, 94th Cong., 2d Sess. 7 (1976); H.R. Rep. No. 94-872, 94th Cong., 2d Sess. 9

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[6]This presumption does not apply, however, when there is damage to the leased property beyond reasonable wear or where there has been excessive use.

[7]The court of appeals removed this restriction. See 563 F. 2d at 1380, 1384.

(1976); 122 Cong. Rec. H1706 (daily ed., March 9, 1976) (remarks of Rep. Wylie). Accordingly, the Board held that the Consumer Leasing Act's requirement that the estimate of the residual value be reasonable is fully consistent with the Board's regulation, and that the "rebuttable presumption" created by the Act would simply cause lessors to adopt conservative estimates of residual values (Pet. App. 11a-12a).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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